As part of our overall strategy, we regularly evaluate opportunities to enter into strategic acquisitions, including potential business combinations and significant investments in complementary companies, assets, products and technologies, although we have no present arrangements, commitments or agreements with respect to any acquisition. Acquisitions involve a number of operating risks that could materially adversely affect our business, financial condition and results of operations, including the diversion of management's attention to assimilate the operations, products and personnel of the acquired companies, the amortization of acquired intangible assets, and the potential loss of key employees of the acquired companies. Furthermore, acquisitions may involve businesses in which we lack experience. Because management has limited experience in acquisitions and we have no experience in integrating acquired companies or technologies into our operations, we cannot assure you that we will be able to manage one or more acquisitions successfully, or that we will be able to integrate the operations, products or personnel gained through any such acquisitions without a material adverse effect on our business, financial condition and results of operations.

Our business may be adversely affected by Year 2000 technology problems.

Many currently installed computer and software products were coded to accept only two digit entries in the date code field. These date code fields need to accept four digit entries to distinguish twenty-first century dates from twentieth century dates. We use off-the-shelf and custom software developed internally and by third parties for our production, information technology (IT) and non-IT systems. We programmed and tested our systems and installed all upgrades necessary to make them Year 2000 compliant. We spent approximately $400,000 to make our systems Year 2000 compliant. As a result of our Year 2000 readiness efforts, our production systems, IT systems and non-IT systems successfully distinguished twenty-first century dates from twentieth century dates on January 1, 2000 without any system failures. However, we are continuing to monitor our systems throughout the year 2000 to ensure that any latent Year 2000 matters that may arise are addressed promptly. Despite the fact that many companies' software and computer systems are currently processing twenty-first century dates correctly, these companies, including us, could experience latent Year 2000 problems.

The market price of our common stock may experience price and volume fluctuations for reasons over which we have no control.

The stock market has from time to time experienced, and is likely to continue to experience, extreme price and volume fluctuations. Recently, prices of securities of high technology companies have been especially volatile and have often fluctuated for reasons that are unrelated to the operating performance of the affected companies. The market price of shares of our common stock has fluctuated greatly since our initial public offering and could continue to fluctuate due to a variety of factors. In the past, companies that have experienced volatility in the market price of their stock have been the objects of securities class action litigation. If we were the object of securities class action litigation, it could result in substantial costs and a diversion of our management's attention and resources.

Our corporate documents and Delaware law make a takeover of our company more difficult, which may limit the market price of the common stock.

Our charter and by-laws and Section 203 of the Delaware General Corporation Law contain provisions that might enable our management to resist a takeover of our company. Among other things, the board of directors has the ability to issue "blank check" preferred stock without further stockholder approval. These provisions may discourage, delay or prevent a change in control or a change in our management. These provisions also could discourage proxy contests and make it more difficult for you and other stockholders to elect directors and take other corporate actions. The existence of these provisions could limit the price that investors are willing to pay for shares of common stock.

Our officers and directors have significant voting power and may substantially influence the outcome of any stockholder vote.

Members of our board of directors and our executive officers, together with members of their families and entities that may be deemed affiliates of or related to such persons or entities, beneficially own approximately 22.6% of the outstanding shares of our common stock as of February 29, 2000. Accordingly, these stockholders are able to influence election of all members of our board of directors and influence the outcome of corporate actions requiring stockholder approval, such as mergers and acquisitions. This level of ownership by such persons and entities may have a significant effect in delaying, deferring or preventing a change in control of us and may adversely affect the voting and other rights of other holders of common stock.

ITEM 2. PROPERTIES

Our principal administrative, sales and marketing, research and development and support facilities consist of approximately 80,000 square feet of office space in Boulder, Colorado. We occupy these premises under a lease expiring December 31, 2002. In December 1999, we leased an additional 2,100 square feet of office space in Austin, Texas. This facility will supplement and serve as a back up to our Boulder, Colorado facility. We occupy the Texas premises under a lease expiring November 30, 2003. We expect to lease additional space in 2000 to accommodate growth.

ITEM 3. LEGAL PROCEEDINGS

We are not a party to any litigation that we believe could have a material adverse effect on us or our business. Federal and state regulations governing 9-1-1 service provisioning have typically applied to local exchange services providers. We plan to provide 9-1-1 services directly to state and local governments rather than local exchange carriers in certain areas. Since this is the first time that such services have been provided in this manner, the regulations are being challenged and clarified for the first time. We believe that the services we provides are within the scope of the existing regulations and that any challenges to the regulations will be decided in our favor. However, if the regulations are challenged and are not decided in our favor, we may be prohibited from expanding our services to certain markets.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

a) On December 2, 1999, we held our 1999 Annual Meeting of Stockholders (the "Annual Meeting").

b) One matter voted on at the Annual Meeting was the election of six directors. The six nominees, who were existing directors and nominees of our Board of Directors, were re-elected at our Annual Meeting as directors, receiving the number and percentage of votes for election and abstentions as set forth next to their respective names below:

NOMINEE FOR DIRECTOR	FOR		ABSTAIN	
George K. Heinrichs	6,301,620	97.6%	154,275	2.4%
Stephen O. James	6,303,898	97.6%	151,997	2.4%
David Kronfeld	6,303,898	97.6%	151,997	2.4%
Mary Beth Vitale	6,302,398	97.6%	153,497	2.4%
Winston J. Wade	6,303,898	97.6%	151,997	2.4%
Darrell A. Williams	6,302,398	97.6%	153,497	2.4%

c) The following additional matter was separately voted upon at the Annual Meeting and received the votes of the holders of the number of shares of our common stock voted in person or by proxy at the Annual Meeting and the percentage of total votes cast as indicated below:

Ratification of selection of Arthur Andersen LLP as independent accountants for 2000 fiscal year:

For	6,306,528	97.7%
Against	10,400	0.2%
Abstain	138,967	2.1%

d) Not applicable.

PART II

ITEM 5a. MARKET FOR THE REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Our common stock is traded on the Nasdaq National Market under the symbol "SCCX." We commenced our initial public offering of the common stock on June 24, 1998 at a price of $12 per share. Prior to such date, there was no public market for the common stock. The following table sets forth the high and low bid prices for the common stock for the periods indicated, as reported on the Nasdaq National Market.

	HIGH	LOW
June 24, 1998 through June 30, 1998	$14.00	$12.00
Quarter ended September 30, 1998	16.00	2.88
Quarter ended December 31, 1998	5.56	2.88
Quarter ended March 31, 1999	6.38	3.00
Quarter ended June 30, 1999	5.00	3.00
Quarter ended September 30, 1999	7.13	4.00
Quarter ended December 31, 1999	7.09	5.00

As of February 29, 2000, there were approximately 173 holders of record.

We have not paid any cash dividends on our capital stock since our inception, and do not expect to pay cash dividends on our common stock in the foreseeable future. Certain covenants contained in our line of credit agreement restrict the payment of dividends without the lender's prior consent. Payments of future dividends, if any, will be at the discretion of our Board of Directors, subject to the restrictions discussed above, after taking into account various factors, including our financial condition, operating results, cash needs and expansion plans.

ITEM 5b. CHANGES IN SECURITIES AND USE OF PROCEEDS

On June 29, 1998, we consummated our initial public offering of our common stock. The estimated net offering proceeds to us after deducting the foregoing discounts, commissions, fees and expenses were $25,988,400, of which $3,510,400 relates to the exercise of the underwriters' over-allotment option on July 22, 1998. Through December 31, 1999, the proceeds of the offering have been applied as follows:

Aggregate offering price	$28,980,000
Direct and indirect payment to others for:	
Underwriting discounts and commissions	2,028,600
Other offering expenses	963,000
Construction of building and facilities	300,000
Capital lease payment to receive discount	2,878,500
Repayment of indebtedness	4,610,000

None of such payments were direct or indirect payments to our directors, officers, general partners or their associates or to persons owning 10% or more of any class of our equity securities or to our affiliates. We expect to use up to $13 million of our remaining net proceeds in 2000 for research, development and marketing to expand our product offerings, as well as for general corporate purposes, including working capital. A portion of the net proceeds also may be used for the acquisition of businesses, products and technologies that are complementary to ours. We invested approximately $15 million of the offering proceeds in an investment portfolio consisting mostly of high-grade bonds and commercial paper.

ITEM 6. SELECTED FINANCIAL DATA

The following selected financial data are qualified by reference to and should be read in conjunction with our financial statements and notes thereto and "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in Item 7. The statement of operations data for the years ended December 31, 1999, 1998 and 1997 and the balance sheet data at December 31, 1999 and 1998 are derived from, and are qualified by reference to, the audited financial statements and notes included in Item 8. The statement of operations data for the years ended December 31, 1996 and 1995 and the balance sheet data at December 31, 1997, 1996 and 1995 are derived from audited financial statements not included in this Annual Report on Form 10-K.

	December 31,				
	1999	1998	1997	1996	1995
Statement of Operations Data:					
Revenue:					
Data management services	$ 32,096	$ 30,610	$ 24,005	$ 13,165	$ 3,531
Licenses and implementation services	488	3,839	3,067	1,637	3,882
Total revenue	32,584	34,449	27,072	14,802	7,413
Costs and expenses:					
Cost of data management services	24,338	20,740	15,378	7,996	2,840
Cost of licenses and implementation services	138	836	1,283	596	1,041
Sales and marketing	5,314	4,119	3,850	3,204	2,016
General and administrative	4,931	4,959	3,227	1,533	830
Total costs and expenses	34,721	30,654	23,738	13,329	6,727
Income (loss) from operations	(2,137)	3,795	3,334	1,473	686
Other income (expense), net	607	(294)	(879)	(527)	(368)
Income (loss) from continuing operations before income taxes	(1,530)	3,501	2,455	946	318
Provision (benefit) for income taxes	(468)	(379)	(2,328)	9	16
Net income (loss) from continuing operations before extraordinary item	(1,062)	3,880	4,783	937	302
Loss from operations of discontinued division, net of tax	(226)	—	(876)	(562)	(1,746)
Loss from disposal of discontinued division, net of tax	—	—	(2,032)	—	—
Net income (loss) before extraordinary item	(1,288)	3,880	1,875	375	(1,444)
Loss from early extinguishment of debt, net of tax	—	(909)	—	—	—
Net income (loss)	$ (1,288)	$ 2,971	$ 1,875	$ 375	$ (1,444)
Per Share Data:					
Net income (loss) from continuing operations before extraordinary item per share:					
Basic	$ (0.10)	$ 0.53	$ 2.17	$ 0.15	$ (0.02)
Diluted	$ (0.10)	$ 0.38	$ 0.54	$ 0.11	$ (0.02)
Net income (loss) per share:					
Basic	$ (0.12)	$ 0.39	$ 0.61	$ (0.17)	$ (1.07)
Diluted	$ (0.12)	$ 0.29	$ 0.21	$ 0.05	$ (1.07)

	December 31,				
	1999	1998	1997	1996	1995
Balance Sheet Data:					
Cash and cash equivalents	$ 8,354	$ 10,266	$ 2,503	$ 32	$ 1,004
Short and long-term investments in marketable securities	13,158	9,815	—	—	—
Working capital (deficit)	18,014	17,678	(2,670)	(7,345)	(8,135)
Total assets	41,780	45,095	21,106	18,482	11,755
Long-term debt	2,038	2,791	6,891	3,318	1,934
Total stockholders' equity (deficit)	32,935	33,591	(11,867)	(13,068)	(4,614)

See Note 2 of notes to financial statements for an explanation of the determination of the shares used in computing net income (loss) per share.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This Annual Report on Form 10-K contains forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from the results discussed in the forward-looking statements. Factors that might cause such a difference include, but are not limited to, those discussed below and in the section entitled "Risk Factors" in Item 1.

Overview

Prior to 1995, substantially all of our revenue was derived from the sale of software licenses and related implementation services to ILECs and public safety agencies. During 1994, we began investing in infrastructure to provide our 9-1-1 OSS solution to telephone operating companies seeking to outsource such operations. We signed our first 9-1-1 data management services contract in August 1994 and continue to add to the number of records under management. We began to recognize revenue from wireless carriers in the third quarter of 1997, and continue to increase the number of live wireless subscribers managed. In addition, we signed a contract with the General Services Commission of the State of Texas in November 1998, representing the first time that a state agency has endeavored to centralize 9-1-1 OSS and data management services with a neutral third party.

Our data management services revenue is derived from contracts with ILECs, CLECs, wireless carriers and a state agency pursuant to which we provide an outsourcing solution for our customers' 9-1-1 data management. Revenue included in data management services generally includes a non-recurring fee for the design and implementation of the 9-1-1 OSS, conversion of the customer's data to our systems, hiring and training of personnel, and other costs required to prepare for the processing of customer data. Non-recurring fees are recognized on the percentage-of-completion method over the period required to perform the tasks necessary to prepare for the processing of customer data. Our contracts also separately allow for a monthly service fee based on the number of subscriber records under management, which is recognized in the period in which the services are rendered. Data management services revenue also may include revenue from enhanced products and services, which may include non-recurring and/or monthly fees which are separately stated in the contract and are recognized in the period in which the services are performed. Related costs are expensed as they are incurred. Data management services revenue comprised 99% of our total revenue in 1999 and 89% in each of the years ended December 31, 1998 and 1997.

Our licenses and implementation services revenue is derived from contracts with ILECs pursuant to which we provide a 9-1-1 software license or related products and services such as implementation, training, software enhancements and interfaces to our customers' systems. Licenses and implementation services revenue is recognized using the percentage-of-completion method. The related costs include third-party licenses, direct labor and related expenses, and are expensed as incurred. Subsequent to system installation, we provide our customers with maintenance services that are recognized ratably over the related contract period on a straight-line basis. Our licenses and implementation services revenue is derived from a limited number of customers and consequently the concentration of customers can result in quarterly fluctuations based on the timing of the signing of new contracts and completion of existing contracts. Margins on such contracts also may fluctuate based on the elements included in the contract. We completed the licenses and implementation services contracts we had in place in 1998 and did not sign additional contracts due to our focus on our longer term services contracts. We do not expect to generate significant revenue from licenses and implementation services during 2000. Licenses and implementation services revenue comprised 1% of our total revenue in 1999 and 11% in each of the years ended December 31, 1998 and 1997.

During the year ended December 31, 1999, we recognized approximately 81% of total revenue from Ameritech, BellSouth Inc. and U S WEST, each of which accounted for greater than 10% of our total revenue. During the year ended December 31, 1998, we recognized approximately 73% of total revenue from Ameritech, BellSouth Inc. and U S WEST, each of which accounted for greater than 10% of our total revenue. During the year ended December 31, 1997, we recognized approximately 81% of total revenue from continuing operations from Ameritech, BellSouth Inc. and U S WEST, each of which accounted for greater than 10% of our total revenue.

In the third quarter of 1998, one of our licenses and implementation services customers, Bell Atlantic, who had merged with Nynex, announced their decision to standardize their 9-1-1 hardware and software platform utilizing non-SCC systems that had been used by Nynex prior to the merger. In the fourth quarter of 1998, we entered into a Termination, Settlement and Release Agreement with Bell Atlantic, under which Bell Atlantic paid us for work that had been performed prior to cancellation of the contract. This transition occurred over the course of 1999, during which time we continued to support the systems installed in Bell Atlantic and cooperated fully to ensure a smooth transition of these systems. Bell Atlantic comprised approximately 8% of our total revenue in 1998.

As of December 31, 1999, we had net operating loss carryforwards of $11.2 million available to offset future net income for U.S. federal income tax purposes. We reversed $1.7 million of the valuation allowance on our deferred tax assets in the year ended December 31, 1998 and recorded an additional income tax benefit of $468,000 from continuing operations in the year ended December 31, 1999, as we believe that it is more likely than not that such tax benefits will be realized. Of the $912,000 tax benefit recorded in 1998, $533,000 related to the extraordinary loss from early extinguishment of debt. We expect to incur losses in the near term related to development costs for new commercial products and future taxable income may not be sufficient to realize additional deferred tax assets that will be created by the projected net operating losses. Consequently, we presently expect our statement of operations will not reflect tax benefits for projected operating losses to be incurred during 2000.

In June 1997, we sold the net assets of our Premise Products Division. The sale of our Premise Products Division resulted in a net loss from the sale of $2.0 million. Net losses from operations of this division totaled $876,000 and $226,000 in 1997 and 1999, respectively, and are presented in our financial statements as loss from operations of discontinued division. The loss from discontinued operations in 1999 resulted from final closeout of unassigned contracts and the transition of customers to the company that acquired this division.

In June and July 1998, we completed an initial public offering of our common stock, which generated proceeds of $26.0 million, net of the underwriter's discount and other offering costs and including the exercise of the underwriters' overallotment option. See Note 2 to the accompanying financial statements and "Liquidity and Capital Resources."

Historically, substantially all of our revenue has been generated from sales to customers in the United States. However, we have generated revenue in Canada and intend to enter additional international markets, which may require significant management attention and financial resources. International sales are subject to a variety of risks.

Our quarterly and annual operating results have varied significantly in the past. The variation in operating results will likely continue and may intensify. We believe that period to period comparisons of results of operations are not necessarily meaningful and should not be relied upon as indications of future performance. Our operating results may continue to fluctuate as a result of many factors, including the length of the sales cycles for new or existing customers, the size, timing or duration of significant customer contracts, fluctuations in number of subscriber records under management, timing or duration of service offerings, rate of adoption of wireless services by Public Safety Answering Points, efforts expended to accelerate the introduction of certain new products, our ability to hire, train and retain qualified personnel, increased competition, changes in operating expenses, changes in our strategy, the financial performance of our customers, changes in telecommunications legislation and regulations that may affect the competitive environment for our services, and general economic factors. Our contracts for 9-1-1 OSS services generally include a separate non-recurring fee for the design and implementation of the 9-1-1 OSS, conversion of the customer's data to our systems, hiring and training of personnel, and other costs required to prepare for the processing of customer data, and therefore, we may recognize significantly increased revenue for a short period of time upon commencing services for a new customer.

Our expense levels are based in significant part on our expectations regarding future revenue. Our revenue is difficult to forecast because the market for our services is evolving rapidly and the length of our sales cycle, the size and timing of significant customer contracts and license fees and the timing of recognition of non-recurring initial fees vary substantially among customers. Accordingly, we may be unable to adjust spending in a timely manner to compensate for any unexpected shortfall in revenue. Any significant shortfall could therefore have a material adverse effect on our business, financial condition and results of operations. We will incur expenses of approximately $10 million in 2000 for research, development and marketing to expand our product offerings. In addition, we hired additional employees in 1999, 1998 and 1997, and expect to continue hiring additional employees during 2000. We also began leasing office space in Texas in December 1999, from which we will perform some of our operations. We cannot assure you that we can report operating profits or that our investments in research and development will generate future revenue. Failure to do so could have a material adverse effect on our business, financial condition and results of operations.

Results of Operations

Year Ended December 31, 1999 Compared to Year Ended December 31, 1998

Revenue

Total Revenue. Total revenue decreased 5%, from $34.4 million in 1998 to $32.6 million in 1999.

Data Management Services Revenue. Revenue from data management services increased 5%, from $30.6 million in 1998 to $32.1 million in 1999, representing approximately 89% and 99% of total revenue, respectively. Data management services revenue increased due to an increase in the number of records under management for ILEC and CLEC customers caused by customer growth and the signing of additional CLEC contracts. These increases were offset by monthly minimum fees from a wireless carrier in 1998 that expired at the end of 1998 and a decrease in non-recurring fees related to wireless and wireline services.

Licenses and Implementation Services. Revenue from licenses and implementation services decreased 87%, from $3.8 million in 1998 to $488,000 in 1999, as we had no licenses and implementation services contracts in process in 1999 other than warranty contracts.

Costs and Expenses

Cost of Data Management Services. Cost of data management services consists primarily of labor and costs of interconnection with customers' systems and our infrastructure. Cost of data management services increased 17%, from $20.7 million in 1998 to $24.3 million in 1999, representing 60% and 75% of total revenue, respectively, and 68% and 76% of data management services revenue, respectively. The dollar increase was due to the pilot phase and start of implementation of our contract with the State of Texas, increased depreciation expense and telephone lines to accommodate growth in our wireless and wireline operations and additional headcount and related costs incurred to accommodate growth for both wireline and wireless services. The percentage increase occurred primarily because the rollout of our wireless and enhanced services has been slower than anticipated, although we have built the infrastructure to service the anticipated demand, and the infrastructure required to begin the State of Texas contract before significant revenue was generated. In addition, in 1998, we received monthly minimum fees from a wireless customer which expired at the end of 1998.

Cost of Licenses and Implementation Services. Cost of licenses and implementation services consists primarily of labor, license fees for third party software and related expenses. Cost of licenses and implementation services decreased 83%, from $836,000 in 1998 to $139,000 in 1999, representing 2% and 0.4% of total revenue, respectively, and 22% and 28% of licenses and implementation services revenue, respectively. The dollar decrease occurred because we had no licenses and implementation services contracts in process during 1999 other than warranty contracts.

Sales and Marketing. Sales and marketing expenses consist primarily of expenses related to salaries and commissions, travel, trade shows and sales collateral. Sales and marketing expenses increased 29%, from $4.1 million in 1998 to $5.3 million in 1999, representing 12% and 16% of total revenue, respectively. The dollar increase was due to the addition of marketing personnel, the creation of a government affairs department to interpret and influence legislation primarily related to our wireless operations and related legal expenses, addition of sales staff for enhanced services and an increase in tradeshow expenses.

General and Administrative. General and administrative expenses consist primarily of expenses related to our information systems, finance, human resources, legal, executive and financial planning departments. General and administrative expenses decreased 1%, from $5.0 million in 1998 to $4.9 million in 1999, representing 14% and 15% of total revenue, respectively. We experienced decreases due to a decrease in expenses related to the resignations of our chief operating officer and chief financial officer. These decreases were partially offset by:

- the addition of information technology personnel and related expenses;
- increased legal and accounting costs related to quarterly and annual reporting requirements as we became a publicly traded company in June 1998;

- increased legal staffing and other fees related to regulatory and legislative issues concerning the implementation of our services in Texas; and
- the creation of an investor relations department.

Other Income (Expense),Net. Net other income (expense) consists primarily of interest expense from our borrowings and leases for capital equipment, offset by interest income earned on our cash and investment balances. Net other expense was $294,000 in 1998 compared to net other income of $607,000 in 1999, representing (1)% and 2% of total revenue for such periods, respectively. The dollar increase in net other income was primarily due to a decrease in interest expense related to the repayment of certain bank debt outstanding through the second quarter of 1998 and repayment of certain capital leases and an increase in interest earned from the investment of funds received from our initial public offering in June and July of 1998.

Benefit for Income Taxes. Our income tax benefit from continuing operations increased from $379,000 in 1998 to $468,000 in 1999. In 1998, we reversed a portion of our valuation allowance and in 1999 recorded an income tax benefit related to our deferred tax assets as we believe that it is more likely than not that the tax assets will be realized.

Loss from Operations of Discontinued Division. We recorded a charge of $226,000 in 1999, net of the related tax benefit, related to the final closeout of unassigned contracts and the transition of customers to the company that acquired this division.

Loss from Early Extinguishment of Debt. We recorded a charge of $909,000 in 1998, net of the related tax benefit, related to the write-off of the remaining debt discount and other costs associated with the early extinguishment of our bank debt.

Year Ended December 31, 1998 Compared to Year Ended December 31, 1997

Revenue

Total Revenue. Total revenue increased 27%, from $27.1 million in 1997 to $34.4 million in 1998.

Data Management Services Revenue. Revenue from data management services increased 28%, from $24.0 million in 1997 to $30.6 million in 1998, representing approximately 89% of total revenue in both periods. The increase resulted primarily from increases in:

- monthly fees from wireline customers due to an increase in the number of subscribers under management;
- non-recurring and monthly fees from wireless customers, as we did not begin to earn revenue from wireless customers until the third quarter of 1997 and signed several new contracts in 1998;
- non-recurring fees from enhanced services; and
- non-recurring fees from new wireline customers that were transitioned to our systems.

Licenses and Implementation Services. Revenue from licenses and implementation services increased 25%, from $3.1 million in 1997 to $3.8 million in 1998, due to increased work performed on contracts that began in 1997 and were completed or terminated during 1998.

Costs and Expenses

Cost of Data Management Services. Cost of data management services increased 35%, from $15.4 million in 1997 to $20.7 million in 1998, representing 57% and 60% of total revenue, respectively, and 64% and 68% of data management services revenue, respectively. The dollar increase was due to the addition of personnel and equipment and expansion of facilities to accommodate growth in our wireless and wireline operations.

Cost of Licenses and Implementation Services. Cost of licenses and implementation services decreased 35%, from $1.3 million in 1997 to $836,000 in 1998, representing 5% and 2% of total revenue, respectively, and 42% and 22% of licenses and implementation services revenue, respectively. The decrease in dollars and as a percent of licenses and implementation services revenue was primarily due to the reversal of accrued third party software fees that will not be required and an increase in warranty revenue, both of which resulted from the cancellation of our contract with Bell Atlantic.

Sales and Marketing. Sales and marketing expenses increased 7%, from $3.9 million in 1997 to $4.1 million in 1998, representing 14% and 12% of total revenue, respectively. The increase was primarily due to salaries and related costs of hiring additional sales and marketing personnel during 1998 and public relations costs incurred in 1998. These increases were partially offset by decreases in sales commissions, as well as the transfer of a vice president to a general and administrative position.

General and Administrative. General and administrative expenses increased 54%, from $3.2 million in 1997 to $5.0 million in 1998, representing 12% and 14% of total revenue, respectively. The dollar increase was due to:

- the reassignment of certain continuing resources, infrastructure and related general and administrative expenses applicable to continuing operations;
- addition of personnel and computer equipment in the accounting, information systems, legal and human resources departments to support our growth;
- the transfer of a marketing vice president to a general and administrative position; and
- strategic consulting costs incurred in 1998.

The increases were partially offset by a decrease in executive bonuses.

Other Expenses, Net. Other expenses decreased 67%, from $879,000 in 1997 to $294,000 in 1998, representing 3% and 1% of total revenue, respectively. The dollar decrease was primarily due to the repayment of certain bank debt and capital leases during 1998 and interest earned from the investment of funds from our initial public offering in June and July of 1998.

Income Tax Benefit. The income tax benefit of $379,000 in 1998 consists of the reversal of a portion of our valuation allowance on our deferred tax assets, compared to a reversal of valuation allowance of $2.4 million in 1997. We did not record a state income tax provision in 1998 primarily due to the utilization of state net operating loss carryforwards. In 1997, we recorded a state provision of $172,000 as more business was conducted in states where net operating loss carryforwards were not available.

Loss from Sale and Operations of Discontinued Division. In 1997, we recorded a charge of $2.9 million, net of the related tax effect, related to the sale of the net assets of our Premise Products Division.

Loss from Early Extinguishment of Debt. We recorded a charge of $909,000 in 1998, net of the related tax benefit, related to the write-off of the remaining debt discount and other costs associated with the early extinguishment of our bank debt.

Liquidity and Capital Resources

Since our inception we have funded our operations with cash provided by operations, supplemented by equity and debt financing and leases on capital equipment. As of December 31, 1999, we had $21.5 million in cash and cash equivalents and investments in marketable securities.

In June 1998, we completed an initial public offering of 2,100,000 shares of our common stock, which generated proceeds of $22.5 million to us, net of the underwriter's discount and other offering costs. We used approximately $4.4 million of the proceeds to repay our bank loans and $160,000 for the related prepayment penalty. In July 1998, the underwriters of our initial public offering exercised their over-allotment option. Under the over-allotment option, we sold an additional 315,000 shares of our common stock, generating net proceeds of $3.5 million.

In addition to the $4.4 million of debt repaid with the proceeds of the initial public offering, we repaid $5.6 million and $1.9 million of other bank debt and capital lease obligations during 1998 and 1999, respectively. Additionally, we used $3.4 million and $2.5 million during 1998 and 1999, respectively, for the purchase of capital assets and software development. We anticipate that our level of spending for capital expenditures in 1999 will continue during 2000, although we currently have no material commitments for capital expenditures.

We have a line of credit with a bank equal to $2.0 million, which is available to meet operating needs. The interest rate on amounts borrowed under the line of credit is equal to the bank's prime rate or the one, two or three month Libor rate plus 2.25% per annum. The line of credit matures April 15, 2000 and is collateralized by certain of our assets. As of December 31, 1999, no borrowings were outstanding on the line of credit.

We also have a $2.0 million capital lease line with a bank which is available to meet capital acquisition needs that arise from normal business operations. The interest rate on capital leased under the lease line is equal to the bank's cost of funds at the time of each lease. Separate lease schedules are signed from time to time. Each lease schedule is collateralized by the assets that are being leased. Each lease has its own termination date, typically 36 months. As of December 31, 1999, $582,000 was outstanding on the capital lease line.

We have announced plans to incur research, development and marketing expenses of approximately $10 million to expand our product offerings. This will require approximately $13 million in cash due to the capital expenditure requirements. We may also increase our capital lease line to finance this initiative. We believe that our remaining net proceeds from our initial public offering, cash generated from operations and lease financing will be sufficient to fund our anticipated working capital needs, research and development initiative, capital expenditures and any potential future acquisitions through at least the next twelve months. In the event our plans or assumptions change or prove to be inaccurate, or if we consummate any unplanned acquisitions of businesses or assets, we may be required to seek additional sources of capital. Sources of additional capital may include public and private equity and debt financings, sales of nonstrategic assets and other financing arrangements.

Year 2000 Capability

Many currently installed computer and software products were coded to accept only two digit entries in the date code field. These date code fields need to accept four digit entries to distinguish twenty-first century dates from twentieth century dates. We use off-the-shelf and custom software developed internally and by third parties for our production, information technology (IT) and non-IT systems. We programmed and tested our systems and installed all upgrades necessary to make them Year 2000 compliant. We spent about $400,000 to make our systems Year 2000 compliant. As a result of our Year 2000 readiness efforts, our production systems, IT systems and non-IT systems successfully distinguished twenty-first century dates from twentieth century dates on January 1, 2000 without any system failures. However, we are continuing to monitor our systems throughout the year 2000 to ensure that any latent Year 2000 matters that may arise are addressed promptly. Despite the fact that many companies' software and computer systems are currently processing twenty-first century dates correctly, these companies, including us, could experience latent Year 2000 problems.

Recently Issued Accounting Pronouncements

Statement of Financial Accounting Standards No. 133 and No. 137

In June 1998, the Financial Accounting Standards Board, or FASB, issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS 133 establishes accounting and reporting standards for derivative financial instruments and hedging activities related to those instruments as well as other hedging activities. It requires an entity to recognize all derivatives as either assets or liabilities in the statement of financial position and measures those instruments at fair value. In June 1999, the FASB issued Statement of Financial Accounting Standards No. 137, "Accounting for Derivative Instruments and Hedging Activities - Deferral of the Effective Date of FASB Statement No. 133 - An amendment of FASB Statement No. 133." SFAS No. 137 delays the effective date of SFAS No. 133 to financial quarters and financial years beginning after June 15, 2000. We do not typically enter into arrangements that would fall under the scope of Statement No. 133 and thus, management believes that Statement No. 133 will not significantly affect our financial condition and results of operations.

Statement of Position 98-9

In December 1998, the American Institute of Certified Public Accountants issued Statement of Position 98-9, "Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions." SOP 98-9 amends certain paragraphs of Statement of Position 97-2, "Software Revenue Recognition," to require the application of a residual method of accounting for software revenue when certain conditions exist. SOP 98-9 also amends Statement of Position 98-4, "Deferral of the Effective Date of a Provision of SOP 97-2" to extend the deferral of the application of certain passages of SOP 97-2 provided by SOP 98-4 through fiscal years beginning on or before March 15, 1999. All other provisions of SOP 98-9 are effective for transactions entered into in fiscal years beginning after March 15, 1999. Earlier adoption is permitted, however, retroactive application is prohibited. We believe SOP 98-9 will not materially impact our financial statements.

Staff Accounting Bulletin No. 101

In December 1999, the Securities and Exchange Commission staff released Staff Accounting Bulletin No. 101, "Revenue Recognition." SAB 101 provides interpretive guidance on the recognition, presentation and disclosure of revenue in financial statements. SAB 101 must be applied to financial statements no later than the second fiscal quarter of 2000. We are currently reviewing SAB 101 to determine what impact, if any, the adoption of SAB 101 will have on our financial position and results of operations.

ITEM 7a. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk represents the risk of loss that may impact our financial position, results of operations or cash flows due to adverse changes in financial and commodity market prices and rates. We are exposed to market risk in the areas of changes in United States interest rates. These exposures are directly related to our normal operating and funding activities. Historically and as of December 31, 1999, we have not used derivative instruments or engaged in hedging activities.

Interest Rate Risk

The interest payable on our line of credit is variable based on the lender's prime rate or the one, two, or three month Libor rate plus 2.25% per annum, and, therefore, is affected by changes in market interest rates. At December 31, 1999, no amounts were outstanding under our line of credit, however, we may borrow up to 80% of qualified accounts receivable, not to exceed $2,000,000. Rates on our capital lease line are also dependent on interest rates in effect at the time the lease line is drawn upon. In addition, we invest excess funds in high-grade treasury bonds and commercial paper on which we monitor interest rates frequently and as the investments mature. We do not believe that reasonably possible near-term changes in interest rates will result in a material effect on our future earnings, fair values or cash flows.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

SCC COMMUNICATIONS CORP.

INDEX TO FINANCIAL STATEMENTS

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Board of Directors and Stockholders of SCC Communications Corp.:

We have audited the accompanying balance sheets of SCC Communications Corp. (a Delaware corporation) as of December 31, 1999 and 1998, and the related statements of operations, stockholders' equity (deficit) and cash flows for each of the three years in the period ended December 31, 1999. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of SCC Communications Corp. as of December 31, 1999 and 1998, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 1999, in conformity with accounting principles generally accepted in the United States.

ARTHUR ANDERSEN LLP

Denver, Colorado
January 21, 2000

SCC COMMUNICATIONS CORP.

BALANCE SHEETS
(dollars in thousands)

	December 31, 1999	December 31, 1998
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 8,354	$ 10,266
Short-term investments in marketable securities	12,165	7,761
Accounts receivable, net of allowance of approximately $58 and $50 in 1999 and 1998, respectively, for doubtful accounts	2,255	4,820
Unbilled revenue	846	1,035
Prepaids and other	548	484
Deferred income taxes — current portion	653	2,025
Total current assets	24,821	26,391
PROPERTY AND EQUIPMENT, at cost:		
Computer hardware and equipment	25,411	23,687
Furniture and fixtures	933	800
Leasehold improvements	915	920
	27,259	25,407
Less — Accumulated depreciation	(15,753)	(11,056)
Total property and equipment	11,506	14,351
OTHER ASSETS	86	112
LONG-TERM INVESTMENTS in marketable securities	993	2,054
DEFERRED INCOME TAXES — NONCURRENT	3,423	1,504
SOFTWARE DEVELOPMENT COSTS, net of accumulated amortization of $575 and $346 in 1999 and 1998, respectively	951	683
	$ 41,780	$ 45,095
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 752	$ 1,211
Payroll-related accruals	786	734
Other accrued liabilities	1,641	2,546
Property and other taxes	792	696
Current portion of capital lease obligations (Note 5)	1,971	1,618
Deferred contract revenue	865	1,908
Total current liabilities	6,807	8,713
LONG-TERM DEBT:		
Capital lease obligations, net of current portion (Note 5)	2,038	2,791
Total liabilities	8,845	11,504
COMMITMENTS AND CONTINGENCIES (Notes 7 and 11)		
STOCKHOLDERS' EQUITY (Note 4):		
Preferred stock, $.001 par value; 15,000,000 shares authorized; none issued or outstanding	—	—
Common stock, $.001 par value; 30,000,000 shares authorized; 11,104,111 and 10,886,353 shares issued at December 31, 1999 and 1998, respectively	11	10
Additional paid-in capital	43,925	43,320
Stock subscriptions receivable	(33)	(59)
Accumulated deficit	(10,968)	(9,680)
Total stockholders' equity	32,935	33,591
	$ 41,780	$ 45,095

The accompanying notes to financial statements are an integral part of these balance sheets.

SCC COMMUNICATIONS CORP.

STATEMENTS OF OPERATIONS
(dollars in thousands, except per share data)

	Year Ended December 31, 1999	1998	1997
REVENUE:			
Data management services	$ 32,096	$ 30,610	$ 24,005
Licenses and implementation services	488	3,839	3,067
Total revenue	32,584	34,449	27,072
COSTS AND EXPENSES:			
Cost of data management services	24,338	20,740	15,378
Cost of licenses and implementation services	138	836	1,283
Sales and marketing	5,314	4,119	3,850
General and administrative	4,931	4,959	3,227
Total costs and expenses	34,721	30,654	23,738
INCOME (LOSS) FROM OPERATIONS	(2,137)	3,795	3,334
OTHER INCOME (EXPENSE):			
Interest and other income	1,095	654	88
Interest and other expense	(488)	(948)	(967)
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES AND EXTRAORDINARY ITEM	(1,530)	3,501	2,455
BENEFIT FOR INCOME TAXES (Note 6)	(468)	(379)	(2,328)
NET INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE EXTRAORDINARY ITEM	(1,062)	3,880	4,783
DISCONTINUED OPERATIONS (Note 3):			
Loss from operations of discontinued division, net of tax	(226)	—	(876)
Loss from disposal of discontinued division, net of tax	—	—	(2,032)
NET INCOME (LOSS) BEFORE EXTRAORDINARY ITEM	(1,288)	3,880	1,875
EXTRAORDINARY LOSS FROM EARLY EXTINGUISHMENT OF DEBT, net of tax	—	(909)	—
NET INCOME (LOSS)	$ (1,288)	$ 2,971	$ 1,875
Dividends accrued on Series D, E and F mandatorily redeemable convertible preferred stock	—	(355)	(740)
Common stock warrant put price adjustment	—	(77)	(8)
NET INCOME (LOSS) APPLICABLE TO COMMON STOCK	$ (1,288)	$ 2,539	$ 1,127
NET INCOME (LOSS) PER SHARE FROM CONTINUING OPERATIONS BEFORE EXTRAORDINARY ITEM (Note 2):			
Basic	$ (0.10)	$ 0.53	$ 2.17
Diluted	$ (0.10)	$ 0.38	$ 0.54
NET INCOME (LOSS) PER SHARE BEFORE EXTRAORDINARY ITEM (Note 2):			
Basic	$ (0.12)	$ 0.53	$ 0.61
Diluted	$ (0.12)	$ 0.38	$ 0.21
NET INCOME (LOSS) PER SHARE (Note 2):			
Basic	$ (0.12)	$ 0.39	$ 0.61
Diluted	$ (0.12)	$ 0.29	$ 0.21
SHARES USED IN COMPUTING NET INCOME (LOSS) PER SHARE (Note 2):			
Basic	10,989,091	6,433,564	1,857,413
Diluted	10,989,091	10,334,556	8,788,816

The accompanying notes to financial statements are an integral part of these statements.

SCC COMMUNICATIONS CORP.

STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)
(dollars in thousands, except per share data)

	Common Stock		Additional Paid-in Capital	Stock Subscriptions Receivable	Treasury Stock		Accumulated Deficit	Total Stockholders' Equity (Deficit)
	Shares	Amount			Shares	Amount		
BALANCES, at December 31, 1996	1,840,899	$ 2	$ 298	$ (19)	(36,250)	$ (3)	$ (13,346)	$ (13,068)
Dividends accrued on Series D, E and F Convertible Preferred Stock	—	—	—	—	—	—	(740)	(740)
Exercise of stock options, including options exercised in exchange for notes receivable	153,382	—	154	(80)	—	—	—	74
Common stock warrant put price adjustment (Note 4)	—	—	—	—	—	—	(8)	(8)
Net income	—	—	—	—	—	—	1,875	1,875
BALANCES, at December 31, 1997	1,994,281	2	452	(99)	(36,250)	(3)	(12,219)	(11,867)
Dividends accrued on Series D, E and F Convertible Preferred Stock	—	—	—	—	—	—	(355)	(355)
Issuance of common stock through Initial Public Offering, net of issuance costs of $964	2,415,000	2	25,985	—	—	—	—	25,987
Conversion of preferred stock into common stock	6,188,575	6	14,938	—	—	—	—	14,944
Conversion of common stock warrants	195,148	—	1,549	—	—	—	—	1,549
Issuance of common stock under Employee Stock Purchase Plan	61,105	—	243	—	—	—	—	243
Exercise of stock options	68,494	—	39	—	—	—	—	39
Common stock warrant put price adjustment	—	—	—	—	—	—	(77)	(77)
Stock subscription payments received	—	—	—	40	—	—	—	40
Tax benefit related to disqualifying dispositions of common stock	—	—	117	—	—	—	—	117
Retirement of treasury stock	(36,250)	—	(3)	—	36,250	3	—	—
Net income	—	—	—	—	—	—	2,971	2,971
BALANCES, at December 31, 1998	10,886,353	10	43,320	(59)	—	—	(9,680)	33,591
Issuance of common stock under Employee Stock Purchase Plan	38,679	—	145	—	—	—	—	145
Exercise of stock options	179,079	1	460	—	—	—	—	461
Stock subscription payments received	—	—	—	26	—	—	—	26
Net loss	—	—	—	—	—	—	(1,288)	(1,288)
BALANCES, at December 31, 1999	11,104,111	$ 11	$ 43,925	$ (33)	—	$ —	$ (10,968)	$ 32,935

The accompanying notes to financial statements are an integral part of these statements.

SCC COMMUNICATIONS CORP.

STATEMENTS OF CASH FLOWS
(dollars in thousands)

	Year Ended December 31, 1999	1998	1997
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income (loss)	$ (1,288)	$ 2,971	$ 1,875
Adjustments to reconcile net income to net cash provided by operating activities —			
Amortization and depreciation	5,117	4,315	3,534
Amortization and write-off of note payable discount	—	1,430	33
Accretion of investments in marketable securities	(284)	(316)	—
(Gain) loss on disposal of assets	53	—	(40)
Loss on disposal of discontinued division	—	—	2,032
Provision for estimated losses on contracts	—	7	(196)
Provision for doubtful accounts	8	—	25
Deferred income tax benefit	(547)	(912)	(2,500)
Change in —			
Accounts receivable	2,557	(2,492)	(977)
Unbilled revenue	189	(39)	(190)
Prepaids and other	(38)	(286)	(202)
Accounts payable	(29)	246	236
Accrued liabilities	(433)	150	1,337
Deferred contract revenue	(1,043)	(705)	303
Decrease in current assets and liabilities from discontinued operations	—	—	110
Net cash provided by operating activities	4,262	4,369	5,380
CASH FLOWS FROM INVESTING ACTIVITIES:			
Acquisition of property and equipment	(1,961)	(2,995)	(2,646)
Proceeds from sale of net assets	—	—	603
Purchase of investments in marketable securities	(14,559)	(14,446)	—
Sale of investments in marketable securities	11,500	4,947	—
Software development costs	(497)	(397)	(142)
Net cash used in investing activities	(5,517)	(12,891)	(2,185)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from issuance of notes payable	—	—	4,275
Principal payments on notes payable	—	(4,986)	(1,439)
Principal payments on capital lease obligations	(1,870)	(5,038)	(3,634)
Proceeds from equipment financing	581	—	—
Exercise of stock options	461	39	74
Stock subscription payments received	26	40	—
Purchases through employee stock purchase plan	145	243	—
Proceeds from initial public offering and overallotment, net of underwriters' discount	—	26,951	—
Costs related to initial public offering	—	(964)	—
Net cash provided by (used in) financing activities	(657)	16,285	(724)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(1,912)	7,763	2,471
CASH AND CASH EQUIVALENTS, beginning of period	10,266	2,503	32
CASH AND CASH EQUIVALENTS, end of period	$ 8,354	$ 10,266	$ 2,503
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:			
Cash paid during the period for interest	$ 439	$ 801	$ 942
Cash paid during the period for taxes	$ 459	$ 95	$ 18
SUPPLEMENTAL SCHEDULE OF NONCASH FINANCING AND INVESTING ACTIVITIES:			
Dividends accrued on Series D, E and F Convertible Preferred Stock	$ —	$ 355	$ 740
Common stock issued to employees in exchange for employee notes receivable	$ —	$ —	$ 80
Property acquired with capital leases	$ 889	$ 3,488	$ 3,074
Conversion of preferred stock	$ —	$ 14,943	$ —
Conversion of warrants	$ —	$ 1,549	$ —
Retirement of treasury stock	$ —	$ 3	$ —

The accompanying notes to financial statements are an integral part of these statements.

SCC COMMUNICATIONS CORP.

NOTES TO FINANCIAL STATEMENTS

(1) ORGANIZATION, BUSINESS AND LIQUIDITY

SCC Communications Corp. (the "Company") is a Delaware corporation. The Company is the leading provider of 9-1-1 operations support systems services to incumbent local exchange carriers ("ILECs"), competitive local exchange carriers ("CLECs"), wireless carriers and state and local governments in the United States. The Company manages the data which enables 9-1-1 calls to be routed to the appropriate public safety agency with accurate and timely information about the caller's identification and location. In addition, the Company licenses its 9-1-1 software to carriers that wish to manage the delivery of 9-1-1 data management services in-house.

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Operating Cycle

Assets and liabilities related to contracts are included in current assets and liabilities in the accompanying balance sheets since they will be liquidated in the normal course of contract completion, although this may require more than one year.

Property and Equipment

Depreciation of property and equipment is computed using the straight-line method over estimated useful lives of three to five years for computer hardware and equipment, seven years for furniture and fixtures and the life of the lease for leasehold improvements. The costs of repairs and maintenance are expensed while enhancements to existing assets are capitalized. Depreciation expense totaled approximately $4,888,000, $4,174,000 and $3,399,000 for the years ended December 31, 1999, 1998 and 1997, respectively.

Software Development Costs

The Company expenses the costs of developing computer software until technological feasibility is established and capitalizes all costs incurred from that time until the software is available for general customer release. Technological feasibility for the Company's computer software products is based upon the earlier of the achievement of (a) a detailed program design free of high-risk development issues or (b) completion of a working model. Costs of major enhancements to existing products with a wide market are capitalized while routine maintenance of existing products is charged to expense as incurred. The establishment of technological feasibility and the ongoing assessment of the recoverability of capitalized computer software development costs requires considerable judgment by management with respect to certain external factors, including, but not limited to, technological feasibility, anticipated future gross revenue, estimated economic life and changes in software and hardware technology.

Capitalized software costs are amortized on a product-by-product basis. The annual amortization is the greater of the amount computed using (a) the ratio that current gross revenue for a product compares to the total of current and anticipated future gross revenue for that product, or (b) the straight-line method over the remaining estimated economic life of the product which is typically five years. Amortization expense related to capitalized software costs totaled approximately $229,000, $145,000 and $107,000 for the years ended December 31, 1999, 1998 and 1997, respectively, and is included in cost of data management services and licenses and implementation services in the statements of operations.

Revenue Recognition

The Company reports revenue based on its two segments, data management services and licenses and implementation services.

Revenue from data management services generally consists of a non-recurring fee and monthly recurring revenue. Revenue included in data management services generally includes a non-recurring fee for the design and implementation of the 9-1-1 OSS, conversion of the customer's data to the Company's systems, hiring and training of personnel, and other costs required to prepare for the processing of customer data. Non-recurring fees are recognized on the percentage-of-completion method over the period required to perform the tasks necessary to prepare for the processing of customer data. The Company's contracts also separately allow for a monthly service fee based on the number of subscriber records under management, which is recognized in the period in which the services are rendered. Data management services revenue also may include revenue from enhanced products and services, which may include non-recurring and/or monthly fees which are separately stated in the contract and are recognized in the period in which the services are performed.

Revenue related to software license fees and implementation of the Company's 9-1-1 systems at customer sites is recognized using the percentage-of-completion method because the Company's software requires significant modification for each customer. Such contracts include a license fee for the use of the Company's software and service fees for the installation and customization of the system. The Company's costs to install its systems include direct labor, third-party license fees and miscellaneous expenses. Such costs are included in cost of licenses and implementation services.

In applying the percentage-of-completion method, revenue and related costs are recognized based on the percentage that labor hours incurred to date compared to total estimated labor hours. Revenue recognized in excess of amounts billed is reflected as unbilled revenue and amounts billed in excess of revenue recognized are reflected as deferred contract revenue in the accompanying balance sheets. The Company recognizes any known or anticipated loss on contracts in process when such losses are determined to exist.

Revenue from licenses and implementation services includes customer support revenue which is recognized ratably over the related contract period on a straight-line basis. Costs related to customer support revenue are included in cost of licenses and implementation services in the accompanying statements of operations.

Concentration of Credit Risk

Financial instruments which potentially subject the Company to concentrations of credit risk are primarily cash and cash equivalents, accounts receivable and investments in high-grade treasury bonds and commercial paper. The Company maintains its cash balances in the form of bank demand deposits, money market accounts, treasury bonds and commercial paper with original maturities less than ninety days. The Company's deposits and investments are with financial institutions that management believes are creditworthy and investments are high-grade. The Company's accounts receivable are from customers that are generally telecommunications service providers; accordingly, the Company's accounts receivable are concentrated in the telecommunications industry. The Company's principal customers (Note 10) accounted for 71% and 30% of the Company's accounts receivable as of December 31, 1999 and 1998, respectively. The Company has no significant financial instruments with off-balance sheet risk of accounting loss, such as foreign exchange contracts, option contracts or other foreign currency hedging arrangements.

Research and Development

Research and development efforts consist of salaries, supplies and other related costs. These costs are expensed as incurred and totaled approximately $1,740,000, $1,376,000 and $738,000 for the years ended December 31, 1999, 1998 and 1997, respectively. These costs are included in cost of data management services and licenses and implementation services in the accompanying statements of operations and do not include development costs incurred as part of the efforts performed under licenses and implementation services contracts with the Company's customers.

Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents include highly liquid investments with original maturities of 90 days or less.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions. These estimates affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Fair Market Value of Financial Instruments

Financial instruments include cash and cash equivalents, corporate debt securities, accounts receivable and debt obligations. The carrying amounts for cash and cash equivalents and accounts receivable approximate fair market value because of the short maturity of these instruments. The fair value of notes are estimated based on current rates available for debt with similar maturities and securities, and at December 31, 1999 and 1998, approximates the carrying value.

Investments in Marketable Securities

The Company's investments in corporate debt securities are classified as held-to-maturity and are carried at the amortized cost basis. The investments had the following values at December 31, 1999 and 1998, respectively:

	Amortized/ Accreted Cost	Accrued Interest	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
Corporate Debt Securities, maturing within one year	$ 7,761,000	$ (237,000)	$ 13,000	$ (2,000)	$ 7,535,000
Corporate Debt Securities, maturing after one year through five years	2,054,000	(33,000)	3,000	—	2,024,000
Balances at December 31, 1998	$ 9,815,000	$ (270,000)	$ 16,000	$ (2,000)	$ 9,559,000
Corporate Debt Securities, maturing within one year	$12,165,000	$ —	$ —	$ (10,000)	$ 12,155,000
Corporate Debt Securities, maturing after one year through five years	993,000	—	—	(2,000)	991,000
Balances at December 31, 1999	$13,158,000	$ —	$ —	$ (12,000)	$13,146,000

Income Taxes

The Company follows Statement of Financial Accounting Standards No. 109 ("SFAS 109"), which requires recognition of deferred income tax assets and liabilities for the expected future income tax consequences, based on enacted tax laws, of temporary differences between the financial reporting and tax basis of assets and liabilities. SFAS 109 also requires recognition of deferred tax assets for the expected future tax effects of loss carryforwards and tax credit carryforwards. Deferred tax assets are then reduced, if deemed necessary, by a valuation allowance for the amount of any tax benefits which, on a more likely than not basis, are not expected to be realized (Note 6).

Stock Based Compensation Plans

The Company applies APB Opinion No. 25, "Accounting for Stock Issued to Employees," ("APB Opinion No. 25") in accounting for its stock option and other stock-based compensation plans for employees and directors. The Company has adopted the disclosure provisions of Statement of Financial Accounting Standards No. 123 ("SFAS 123"), "Accounting for Stock-Based Compensation," for such options and stock-based plans for employees and directors (Note 4).

Impairment of Long-Lived Assets

The Company reviews its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable from future undiscounted cash flows. Impairment losses are recorded for the excess, if any, of the carrying value over the fair value of the long-lived assets.

Earnings Per Share

The Company presents basic and diluted earnings or loss per share in accordance with Statement of Financial Accounting Standards No. 128 "Earnings Per Share" ("SFAS 128"), which establishes standards for computing and presenting basic and diluted earnings per share. Under this statement, basic income (loss) per share is determined by dividing net income (loss) available to common shareholders by the weighted average number of common shares outstanding during each period. Diluted income (loss) per share includes the effects of potentially issuable common stock, but only if dilutive (i.e., a loss per share is never reduced). The treasury stock method, using the average price of the Company's common stock for the period, is applied to determine dilution from options and warrants. The if-converted method is used for convertible securities. Potentially dilutive common stock options that were excluded from the calculation of diluted income per share because their effect is antidilutive totaled 1,085,747, 51,000 and 298,017 in 1999, 1998 and 1997, respectively.

A reconciliation of the numerators and denominators used in computing per share net income from continuing operations is as follows:

	Year Ended December 31,		
	1999	1998	1997
Numerator:			
Net income (loss) from continuing operations before extraordinary item (numerator for diluted loss per share)	$ (1,062,000)	$ 3,880,000	$ 4,783,000
Dividends on Convertible Preferred Stock	—	(355,000)	(740,000)
Common stock warrant put price adjustment	—	(77,000)	(8,000)
Numerator for basic income (loss) per share from continuing operations before extraordinary item	$ (1,062,000)	$ 3,448,000	$ 4,035,000
Denominator for basic income (loss) per share:			
Weighted average common shares outstanding	10,989,091	6,433,564	1,857,413
Denominator for diluted income (loss) per share:			
Convertible Preferred Stock	—	3,051,900	6,188,575
Weighted average common shares outstanding	10,989,091	6,433,564	1,857,413
Options issued to employees	—	752,863	720,605
Putable common stock warrant	—	96,229	22,223
Denominator for diluted income (loss) per share	10,989,091	10,334,556	8,788,816

Income (loss) per common share was computed as follows:

	Year Ended December 31,		
	1999	1998	1997
Basic income (loss) per share:			
Income (loss) per share from continuing operations before extraordinary item	$ (0.10)	$ 0.53	$ 2.17
Loss per share from discontinued operations	(0.02)	—	(1.56)
Loss per share from extraordinary item	—	(0.14)	—
Basic income (loss) per share	$ (0.12)	$ 0.39	$ 0.61
Diluted income (loss) per share:			
Income (loss) per share from continuing operations	$ (0.10)	$ 0.38	$ 0.54
Loss per share from discontinued operations	(0.02)	—	(0.33)
Loss per share from extraordinary item	—	(0.09)	—
Diluted income (loss) per share	$ (0.12)	$ 0.29	$ 0.21

Recently Issued Accounting Pronouncements

Statement of Financial Accounting Standards No. 133 and No. 137

In June 1998, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS No. 133"). SFAS No. 133 establishes accounting and reporting standards for derivative financial instruments and hedging activities related to those instruments as well as other hedging activities. It requires an entity to recognize all derivatives as either assets or liabilities in the statement of financial position and measures those instruments at fair value. In June 1999,